INTEREST RATES REMAIN STABLE UNDER MIXED CIRCUMSTANCES

Bum-Koo Kim
(bkkim@hri.co.kr)

Factors of rise and fall have been mixed in the bond market, and the corporate bond yield remained stable around 8.0% on account of the following demand-supply conditions in June.

In early June, the monetary authorities decided to induce the interest rates to stay as they were in May. This soothed the market players' worries about possible interest rate jump caused by the increasing money demand along with the economic recovery. The gap between long-term and short-term interest rates, which once widened up to 3.0%p, attracted institutional investors with abundant liquidity to buy long-term bonds. The supply of long-term bonds continued to decline mainly due to the slowdown of corporate money demand. In addition many companies refrained from issuing corporate bonds and instead switched to obtaining financing directly through the stock market. The postponement of government bond issuance worth 2.4 trillion won, which was originally scheduled in June, also acted as a demand factor. Against this favorable backdrop, the corporate bond yield moved down to the 7% range in mid-June.

The downward trend did not last, however. Some rising factors restricted an additional drop of the long-term interest rates. Above all, worries about the possible interest rate hike are still hovering because corporate money demand may increase and the government may abandon its low interest rate policy to alleviate the increasing inflationary pressures. Moreover, unfavorable variables surrounding the market acted as rising factors—for example, a possible rise in U.S. interest rates and sudden tension between South and North Koreas. Reflecting these mixed circumstances, the corporate bond yield has shown a bit of fluctuation within a tight range around 8.0% since mid-June.

On the other hand, the government bond yield, thanks to the excessive competition among financial institutions to be selected as a primary dealer, began to reflect the recent trend in the bond market and rose to the 7% range from the middle of June, when the general selection procedure came to an end.

The situation will not change dramatically in July. The economic recovery continues to develop at a rapid speed, but the absolute volume of corporate investment still falls short of the pre-crisis level. The inflationary pressures are low, with a consumer price upsurge of 0.6% year-over-year during the first half of 1999. These factors will help the monetary authorities keep their present stance of a low interest rate policy. VIP

Table 1. Major Interest Rates

(End of Period, %)

	1997	1998	1999					
			Jan	Feb	Mar	Apr	May	Jun 28
Call rate (overnight)	26.59	6.53	6.15	5.14	4.88	4.72	4.73	4.75
CD rate (91 days)	25.00	7.70	6.77	6.61	6.55	5.80	6.25	6.36
Corporate Bond Yield (3 yr.)	28.98	8.00	8.13	8.65	8.10	7.74	8.37	8.01
Government Bond Yield (3 yr.)	-	6.95	7.05	6.96	6.50	6.66	6.67	7.35

Source : Bank of Korea